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Financial Information for Decision Making: An Alternative Small Firm Perspective

Brian Gibson

Successful decision making in small firms requires the availability of financial information and its deployment in a variety of financial management techniques. This prescriptive dictate and the techniques and practices it advocates have developed from, and are supported by, a framework of assumptions derived from mainstream neoclassical economics. Substantial relaxation of these assumptions is often necessary to provide plausible explanations for many observed practices such as the irregular use of financial information in small firm decision contexts. Rather than seeking to justify these departures within the extant framework, understanding may be better accommodated by adopting a different perspective. Concerned primarily with the role of entrepreneurs in the market process, the Austrian school of economic thought appears well placed to provide an appropriate framework for the study of small firms. Financial information in this alternative framework is likely to have a different, less prescriptive, role in decision making.

An arguably important determinant of successful decision making in small firms is the availability of financial information and its deployment in a variety of financial management techniques. These techniques and practices have developed from and are supported by a framework of assumptions derived from mainstream neoclassical economics. However, in order to accommodate observed practice (for example, the irregular use of financial information in decision making, noticeable particularly in small firms) such assumptions often require substantial modification. Rather than seeking to justify these departures within the extant framework, understanding may be better accommodated by adopting a different approach. An appropriate perspective for an alternative framework is that espoused within the Austrian school of economic thought. Concerned primarily with the role of entrepreneurs in the market process, the Austrian approach appears well placed to provide an economic framework for the study of small firms.

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Startling new research results are not presented in this paper. Rather, extant knowledge is presented in a unique (for small business financial management research) but exploratory line of reasoning. If, in due course, the tentative conclusions drawn in this paper are able to be supported, important implications arise. There may be no foundation for the emphasis placed on financial management in small firms. For most small businesses, the acquisition of financial information may cease to offer any benefit beyond the simple determination of the owner/manager's current financial position.

This paper commences with a review of the economic assumptions underlying the traditional view of decision making and information use. Examples of departures from the decision making behaviour implied in this mainstream framework are then briefly discussed. Next, the assumptions embodied in an alternative interpretive economic view are considered with emphasis on a comparison of the knowledge acquisition process implied in both the mainstream and alternative frameworks. The paper concludes with a discussion of a number of implications for small firm financial management research which follow from the ideas developed in the earlier sections of the paper.

THE TRADITIONAL VIEW OF FINANCIAL INFORMATION NEEDS

The traditional, or mainstream, view of the role of financial information in the decision making process of small firm owner/managers shows an evolutionary pattern which is common to many other aspects of business activity: the need for financial information in managerial decision making has been primarily analyzed within a framework based on the utility maximizing assumptions of mainstream neoclassical economics; financial management theories, exemplified in this paper by developments in the management accounting domain, have prescribed decision making behaviour based on these assumptions; and, although most developments have occurred from the study and consideration of large firms, the prescriptions have flowed through to decision making activities in small organizations.

The "marginal revolution" of the late nineteenth century heralded the development of economic theories based on the expectation that both consumers and producers would strive for optimum positions in order to "maximise such magnitudes as satisfaction or net revenue" (Spiegel [19] p. 505). Decades of development and refinement have seen the emergence of a general model of individual decision making in which decision makers are hypothesized to consider the utility of the outcomes associated with every

action that might be taken for every possible state of nature. The optimum decision is taken by choosing, from all possible actions, that action which has the maximum expected utility.

Ideally, in the synthetic world of economic model builders, it is assumed that complete information is available to enable the determination of: all possible actions and states; expectations about the likelihood of states; and, measures of utility (payoffs) for each action/state combination. In the absence of complete and perfect information, the possibility is acknowledged that the action chosen may not result in the optimum outcome. Extensions of the basic model suggest that the likelihood of making the correct decision can be improved by incurring additional costs to acquire more information. The search for further information will continue, when guided by the actions of a rational economic being, until the marginal benefit of having the information equals the marginal cost of its acquisition.

Historically, financial data have been regarded as an important source of information likely to be considered by a rational economic decision maker. Not surprisingly, theories of financial management (theories concerned with the use of financial data in business decision making) have been considerably influenced by the neoclassical economics decision making model. The extent of this influence can be seen by concentrating on developments concerning the accounting function. Accounting is an integral aspect of financial management and it is suggested that developments in accounting theory are equally applicable in the broader financial management domain.

The extent of the influence of conventional neoclassical economics on accounting theory evolution is most apparent in a classification developed by Chua [3] in which it is suggested the following beliefs about physical and social reality dominate the assumptions of mainstream accounting:

1. empirical reality is objective and external to the subject to the extent that human beings are not seen as makers of social reality but are characterized as passive objects; and,
2. a single goal of utility maximization exists for all individuals and firms (Chua [3] p. 611).

The emphasis in these assumptions clearly associates the dominant world view of financial management theory development (as exemplified by accounting) with mainstream neoclassical economics. At a more practical level, the role and purpose of accounting and financial management has long been closely linked with the information needs of “rational” economic decision makers. Most accountants and financial managers would agree “that one of the primary roles served by [financial] systems is the provision of information for learning about problems, outcomes and opportunities”

(Ferris and Haskins [5] p. 6). Similar agreement would be expected for the proposition that the technical rationale for the existence and prosperity of financial management is “the provision of ‘useful’ and ‘relevant’ financial information for the making of economic decisions” (Chua [3] p. 609).

The influence of the neoclassical economics model has extended to the exposition of normative prescriptions for rational decision making behaviour by individuals and firms. This is not generally the intent of economists whose models and theories are “only meant to generate testable hypotheses about the economic activities of firms in aggregate” (Scapens [17] p. 13). Financial management and accounting theorists, nonetheless, appear to have afforded a prescriptive status to economists’ assumptions concerning decision making behaviour. Management accounting researchers, especially, have used the “ideal behaviour interpretation of the neoclassical theory of the firm to develop techniques which could assist decision-makers in firms to achieve their assumed objective of profit maximisation” (Scapens and Arnold [18] p. 92).

Although a disproportionately high volume of financial management and accounting research has occurred in large organizational contexts, the above rationale has also been applied to smaller organizations. To ensure that the most efficient and effective (i.e., goal optimizing) decisions are made, it is argued that small business owner/managers must have access to financial information (for example, McMahan [11] p. 22 and Meredith [13] pp. 11-14). To facilitate planning (i.e., the modelling of expectations), strong arguments are presented for the need to have financial information which reflects the future in the form of budgets (Meredith [13] p. 184). Accounting and financial management theory developments, based on economic assumptions, have therefore resulted in a general contention that small business decision makers need future oriented financial information to be able to make effective decisions.

EXPLAINING DEPARTURES FROM THE TRADITIONAL FRAMEWORK

As the prescribed financial information needs of decision makers have evolved from assumptions of an idealized world, it is not surprising, in an environment which is far from ideal, that departures should be observed in both large and small firm contexts. The manner by which theorists deal with these departures are varied but principally include: the exposition of alternative economic theories within the mainstream neoclassical framework; the extension of psychologically based theories of human information processing; and, especially in accounting and financial

management, recourse to external influence explanations using contingency theories.

Exceptions to the expectation of those that prescribe roles for information use in decision making appear to be common. Suggestions that “simple and sometimes apparently ‘unrealistic’ techniques are frequently observed in practice” (Scapens [17] p. 121) occur regularly in accounting and financial management research literature. So too do suggestions that “information seems to be gathered and processed with scant regard for its relevance to specific decisions” (March [10] p. 151). In small business research it is generally accepted that “owner/managers rarely have ready access to all of the information necessary to conduct the many aspects of their business operations effectively” (Holmes and Nicholls [7] p. 143).

Attempts have been made to explain, or at least accommodate, the occurrence of these observed departures from prescribed behaviour. In economics the ambiguity associated with the notion of “the firm’s objective” has led to the exposition of two categories of alternative theories of the firm (Scapens and Arnold [18] p. 86). These theories reject the notions of perfect competition and single objective functions. Management theories, the first category, concentrate on the conflicting objectives of two groups, owners and managers. The second category, behavioural theories, recognize an even larger number of groups with different objectives and differing amounts of power (Scapens and Arnold [18] p. 89). Perhaps because they do not deal with the structure evident in most small businesses (where owners and managers are rarely separated) there seems to be little development of these theories in small firm economics.

While mainstream neoclassical economics has generally ignored these types of small firm anomalies (Brock and Evans [1]), other bases of explanation are evident. For example, a considerable body of literature with psychological foundations exists in the area of human information processing (Otley [14] p. 12; Scapens [17] p. 134) which concentrates on variables peculiar to the decision maker. A general conclusion from such literature is that the way information is used “appears to be a function, at least in part, of ... individual differences” (Ferris and Haskins [5] p. 9). Perhaps because research into small business financial management “has been largely exploratory and descriptive in nature” (McMahon and Holmes [12] p. 27), there is very little research which specifically links personal characteristics of small business decision makers to financial information use. However, relationships between individual characteristics and “desirable” management practices such as planning have been more extensively researched. Planning using anticipatory financial data is an activity associated with “rational” decision making. Hence, results that indicate a connection between personal characteristics and a preference

toward planning (for example, Carland, Carland and Aby [2] p. 32) may also be used to suggest that the personal characteristics of small business owner/managers will influence financial information use in decision making. Similarly, clear well defined goals or objectives are implied in the normative decision model, but there are "legions of attitude surveys ... [which] have shown that the small firm owner pursues a variety of different objectives in managing his business activities" (Storey [20] p. 178). This diversity of objectives has in turn been linked to individual behaviour differences and personal characteristics (d'Amboise and Muldowney [4] p. 229). Thus, psychology based interpretations of individual personality effects constitute one source of explanation for departures by small business owner/managers from prescribed decision making behaviour.

Another more general approach is to suggest that departures can be explained by adopting a contingency theory. A universal information system to suit all organizations is implied in the static neoclassical decision making model. Departures, it is argued, must be associated with factors which decision makers are unable to influence. The economic environment, organizational structure, and technology have each been identified as principal explanatory variables for the observed existence of differing information systems (Otley [14] p. 7). Holmes and Nicholls [7], identify possible explanatory variables in their small business research. A connection appears to exist between the amount and nature of financial information prepared or acquired by small business owner/managers and a number of "explanatory" variables including: business size; business age; industrial sector; and, owner/manager education (Holmes and Nicholls [7] p. 145).

The preceding selective examples are intended only to be indicative of the variety of arguments used in attempts to explain observed departures from prescribed decision making behaviour. They may be classified as falling within one of two domains: those that modify the neoclassical economic model (by attempting to introduce some latitude into the model's static assumptions); and, those that venture outside, or at least to the limits of, economic explanation (by relying more on psychological foundations). Whilst they do confirm that neoclassical assumptions lack realism when applied in individual contexts, these various approaches do not seem to offer any coherent framework to guide the understanding of financial information use in small firms.

AN ALTERNATIVE VIEW OF FINANCIAL INFORMATION NEEDS

The type of observed departures from prescribed decision making behaviour and the effect of individual characteristics on information use discussed in

the preceding section, have, along with other considerations, influenced the exposition (especially within the accounting domain) of an alternative interpretive framework. Such a framework can be associated with the Austrian school of economic thought with its “emphasis on social processes of discovery” (Kirzner [8] p. 3). If such an association is accepted then our understanding of the essential financial information required by purposive decision makers will significantly alter.

While it does not yet enjoy a wide acceptance, there is an alternative view of accounting (and financial management) theory which constitutes an attempt to move into a domain which recognizes the wider social framework in which information is used. It does not construct “rigorous but artificial models of human action ... [but] ... seeks the actor’s definition of the situation and analyses how this is woven into a wider social framework” (Chua [3] p. 618). At the core of this alternative are the following beliefs about physical and social reality:

1. social reality is subjectively created and objectified through human interaction; and,
2. all actions have meaning and intention that are retrospectively endowed and that are grounded in social and historical practices. (Chua [3] p. 615)

The subjective focus of these beliefs could be used as the basis of arguments which would direct accounting and financial management away from their economic roots. But as Lavoie ([9] p. 598) suggests there is no need for an interpretive perspective to turn away from economics. Rather, because financial management “serves a vital coordinative role in the economy” (Lavoie [9] p. 600), there is a need for financial management theories to maintain their economic perspectives. Lavoie suggests the Austrian school of neoclassical economics has the potential to provide an appropriate framework for the interpretive perspective.

Austrian economics is primarily concerned with purposive human action in markets. To guide purposive action “the individual actor must have chosen certain goals which, if achieved, he believes will leave him better off in some way which is valuable to him” (Reekie [15] p. 28). Means are employed which the actor believes will help in the achievement of desired ends. Importantly, however, there are “no judgements as to whether the individual’s value scale is ‘right’ in any moral or welfare sense, nor whether [the] chosen means will in fact attain [the] desired ends” (Reekie [15] p. 28). Concern is with the consequences of each purposive action and not with the specific rationale underlying the action.

The Austrian perspective does not indicate complete rejection of mainstream economic theory. Contemporary economists and Austrians agree on issues "like the importance of scarcity, the logic of supply and demand, [and] the chief causes of inflation" (Lavoie [9] p. 596). There are, however, considerable methodological differences. Austrian economists are concerned with human action and the manner by which it affects the economic market process. As each action is unique there is no place for the aggregate models of mainstream neoclassical economics in which judgement has no place. "By contrast, in the dynamic economy, knowledge is neither complete nor perfect, therefore markets are constantly in states of disequilibrium ... [which] gives scope to the entrepreneurial function" (Hebert and Link [6] p. 46). Explaining the acquisition and use of knowledge is one area in which Austrian economics differs from the mainstream view.

Information Acquisition and Use

Especially from the perspective of assessing financial information needs, the most critical differences which exist between the mainstream and Austrian schools is in the manner by which economic actors acquire knowledge and information for use in decision making. Economic actors behaving in accordance with mainstream neoclassical views are assumed to acquire knowledge through a deliberate search for information with the intent of moving toward an ex-ante market equilibrium. Such behaviour has a positive cost limited only by assessment of the information's benefit. Proponents of the Austrian perspective argue that there need be no deliberate search for information. Knowledge may be acquired merely by alertness to opportunities and therefore have no positive cost (Reekie [15] p. 94). Experiences are gained by participation in the market process. Discrepancies exist between the prices in one market and those in another, which entrepreneurs seek to lessen. If the assessment of market opportunities is correct, the reward is profit. If it is incorrect, loss. This process moves the market toward equilibrium, but in a world of continuous discovery and error, such a state is never attained (Young [21] p. 12). The key to entrepreneurial activity is not knowledge per se but alertness to opportunity. Entrepreneurs, according to Austrian economists, react to opportunities as they become aware of their existence and, by virtue of that reaction, move toward a perceived (but constantly receding) future market equilibrium.

The emphasis placed on information acquisition by discovery through alertness implies a reduced need for structured calculative information. However, financial information still has a role according to the Austrian perspective. Decision makers do need financial information to help them determine if their capacity to generate future profit (i.e., take a particular

action) has been impaired (Young [21] p. 13). There is no assumption that financial information has any other role. It is not assumed that future oriented information will be used in evaluating the means by which desired ends can be achieved (although such use is not precluded). Austrian economics offers no opportunity to prescribe a use for information in the decision making process. It suggests, rather, that interest is restricted to ascertaining the economic value of resources available to enable the implementation of alternative means of reaching a desired end.

There is, therefore, in the interpretive framework of the Austrians a viable economic alternative to guide the development of small firm financial management theory. Understanding entrepreneurial decision making may not require rigorous artificial models of human action. Observed departures from these traditional models may be better understood, not by relaxing assumptions or turning to other disciplines, but by adopting an interpretive economic framework. Examined within such a framework it is possible that "simpler solutions [such as] cash-based accounting systems may be perfectly adequate" (McMahon and Holmes [12] p. 27) when addressing the financial information needs of small firms.

IMPLICATIONS AND CONCLUSIONS

This paper does not provide any startling new discovery nor does it present an in depth probing of alternative views. The arguments presented and the sequence of their presentation do, nonetheless, give rise to some important issues. The implications of these issues must be considered by researchers interested in financial management and financial information use in small business.

Importantly, there needs to be more research and a more coherent framework to guide that research. Despite the importance of the study of small business economics (Brock and Evans [1] p. 8), many empirical studies into small firm issues appear to lack an "understanding of the internal mechanisms of small business" (Romano [16] p. 35). Perhaps research into small business is likely to benefit from the adoption of a more liberal interpretive economic framework in which researchers could "concentrate on studying business persons in action in their environment" (d'Amboise and Muldowney [4] p. 237). Acceptance of the Austrian view of entrepreneurial action may provide the foundation for such an interpretive framework.

An important implication of accepting the Austrian view of economic activity may be a severe weakening of the importance previously attached to the availability of financial information. The lack of interest in financial

information that many small business owner/managers exhibit is consistent with the Austrian view of economic behaviour. Researchers, and policy makers, may need to accept that there is unlikely to be a unique combination of situations and/or personality characteristics which describe a "perfect" small business information user. Coercing all small business owner/managers to make greater use of financial information may never result in any widespread change to the nature of decision making in small firms.

Such a radical transposition of views will require more forceful argument than that presented here. It must be acknowledged that many reported small business research results indicate some behaviour consistent with the assumptions of both the mainstream and alternative views. A mainstream economist might argue that owner/managers observed to be making decisions without attempting to utilize all available information are acting in an "irrational" manner and that if they do succeed in attaining their objectives they do so by luck. A more feasible argument is that such behaviour may be satisficing rather than optimizing. Austrian economists, on the other hand, might argue that actors who appear to follow the neoclassical procedure do so merely because it appears to be an appropriate means by which they can achieve their desired ends. The more cynical may suggest that decision makers appear to utilize calculative procedures purely to justify their entrepreneurial actions to doubting peers (possibly including accountants, finance providers and social scientists). Understanding the importance of financial information in small organizations requires resolution of these conflicting explanations. Such resolution can only be achieved by continued study of actual decision making processes adopted in small firm settings.

This paper has done no more than raise the possibility that an interpretive framework is more appropriate in developing economic, accounting, and financial management theories. The essence of the interpretive economic framework is entrepreneurial action. No other economic framework is so directly associated with the subject matter of small business research. There are no unchallengeable conclusions to the ideas developed in this paper. Like one of the alternatives it explores, any conclusions remain a matter of interpretation. Small business researchers, especially those concerned with financial information use, must at least explore the issues raised in this paper.

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